COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Cambridge Electric Light Company	)	**D.T.E. 04-60**
Commonwealth Electric Company	)	
d/b/a NSTAR Electric	)	
	)	

INITIAL BRIEF OF THE ATTORNEY GENERAL
(REDACTED VERSION)

Respectfully submitted,

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I. INTRODUCTION

This case concerns a Petition ("Petition") by Cambridge Electric Light Company ("Cambridge") and Commonwealth Electric Company ("Commonwealth"), together with Boston Edison Company, d/b/a NSTAR Electric (the "Company" or "NSTAR Electric"), for Department approval of buyouts of two purchased power agreements ("PPAs") with Pittsfield Generating Company, L.P. (formerly known as Altresco Pittsfield, L.P.) ("Pittsfield") and related rate recovery.

II. PROCEDURAL HISTORY

On June 29, 2004, pursuant to G.L. c. 164, §§1A, 1G, 76, 94 and 94A, NSTAR Electric filed a Petition with the Department for approval of the buyout and termination of the Pittsfield contract. On July 21, 2004, the Department conducted a public hearing and a procedural conference to establish a schedule for discovery, hearings and briefs. At this conference, the Department granted full intervenor status to Pittsfield Generating Company, L.P.

The Department conducted an evidentiary hearing on August 5, 2004. During the evidentiary hearing, NSTAR Electric presented two witnesses to testify in support of its proposal,

Geoffrey O. Lubbock, Vice President of Financial Strategic Planning and Policy for NSTAR Electric, and Robert B. Hevert, President of Concentric Energy Advisors, Inc ("CEA").

III. THE COMPANY'S PROPOSAL

In 1992, Cambridge and Commonwealth both entered into PPAs with Pittsfield. *See* Exh. NSTAR-CAM-GOL-1 and Exh. NSTAR-COM-GOL-1. Under each PPA, the Company is entitled to 17.2 percent of the summer and winter energy and capacity. Exh. NSTAR-RBH, p. 24. Both PPAs are to terminate on December 31, 2011. *Id*.

As a result of a 2003 auction for all of the Company's remaining PPA contracts, including the Pittsfield contracts, the Company determined that a buyout was the best solution[1] and created the greatest possible reduction in above-market costs.[2] *Id*. at 21. On June 2, 2004, the Company and Pittsfield executed the two Termination Agreements that are the subject of the Company's Petition.

If approved, the Termination Agreements would relieve the Company of its obligations to purchase or accept electricity produced at Pittsfield's generating facility. Under the Termination Agreements, the Company would be required to make termination payments of $1.67 million per month for a total of $85.17 million to Pittsfield from October 1, 2004 until December 31, 2008.

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[1] Working with its consultant CEA, the Company assigned a market value to the PPAs using variables such as (1) the market price of energy and capacity; (2) the contract price of energy and capacity; (3) the projected energy production; (4) fuel costs; (5) capital costs; and (6) a transmission charge (included in Cambridge's PPA only). Exh. NSTAR-RBH, p. 25. CEA used a discount rate of 7.82 percent for the evaluation of these contracts and bids.

[2] The Company calculated above-market costs as the present value of the difference between the expected total cost under the PPA terms and the market value based on the Henwood Energy Service Inc.'s ("Henwood") Northeast Electricity and Gas Price Outlook for Fall 2003, with updates in March and May, 2004 for years 2004 through 2006 ("Northeast Electric and Gas Price Forecast"). Exh. NSTAR-RBH, p. 18.

The Company states that the proposed Termination Agreements will result in approximately $3.888 million in customer savings on a net present value basis for Cambridge and $3.1 million for Commonwealth customers, for a total of $6.988 million in customer savings on a net present value basis. The Company also asks the Department to approve its proposal to pass the costs relating to the Termination Agreements through the respective transition charges of Cambridge and Commonwealth.

IV. STANDARD OF REVIEW

The Company is required to seek to mitigate to the maximum extent possible the total amount of transition costs recovered and to minimize the impact of recovery of transition costs on ratepayers. G.L. c. 164 §1G(d)(1) (the "Restructuring Act"). Mitigation efforts in which the Company shall engage shall include (1) good faith efforts to renegotiate, restructure, reaffirm, terminate or dispose of existing contractual commitments for purchased power which exceed the competitive market price for power; (2) examination and analysis of the historic level of performance over the life of contractual commitments for purchase power, regardless of whether or not they exceed the competitive market price; (3) any other mitigation and analytical activities the Department determines to be reasonable and effective mechanisms for reducing identifiable transition costs. G.L. c. 164 §1G(d)(1)(ii), (iii), (vi).

According to the Restructuring Act, beginning July 1, 1998, and at least annually thereafter, the Department shall review purchased power contracts approved on or by December 31,1995 in order to determine if the contracts contain a price for electricity which is above-market as of the date of review. G.L. c. 164 §1G(d)(2)(i). If the Department determines a contract to be above-market, the electric company and the seller shall attempt to make a good-

faith effort to renegotiate the contract in order to achieve further reductions in the transition charge. G.L. c. 164 §1G(d)(2)(i).

Also, the Department determines whether the Company has indeed maximized the level of mitigation. *Cambridge Electric Light Company/Canal Electric Company/Commonwealth Electric Company*, D.P.U./D.T.E. 97-111, p. 64 (1998). The Department is authorized to approve the recovery of costs associated with a contract restructuring if the buyout is likely to achieve customer savings and is otherwise in the public interest. G.L. c. 164 §1G(b)(1)(iv).

The Department must also determine, similar to its analyses of settlement agreements, whether the proposed contract termination is reasonable. *See Plymouth Rock Energy Associates, L.P.*, D.P.U./D.T.E. 92-122-B (1999). In assessing the reasonableness of an agreement, the Department must review all available information to ensure that the agreement is consistent with the public interest and in the context of the precedent regarding buyouts of purchase power contracts. *Commonwealth Electric Company*, D.P.U. 91-200, p. 5-6 (1993); *Boston Edison Company*, D.P.U. 92-183 (1992) (Department approved termination agreement of a purchase power contract with Down East Peat, L.P., as it was submitted).

V. ARGUMENT

The Department should reject the Company's petition because the Company has failed to establish that the proposed termination agreement complies with the maximum mitigation requirement of the Restructuring Act. Although this Petition may result in savings to customers

under certain assumptions, those savings are very small.[3] The Company does not appear to have explored other ways to terminate the Pittsfield PPAs that may have yielded greater savings to ratepayers and further mitigated the transition costs. When assigning a value to the PPAs, the Company and CEA did not account for factors that may have altered the market value of the PPAs and allowed the Company to negotiate a lower buyout price with Pittsfield. In addition, the financial models the Company and CEA relied on as evidence in support of the Company's Petition contained errors that undermine their credibility.

A. THE COMPANY DID NOT FULLY EXERCISE ITS CONTRACTUAL RIGHTS TO MITIGATE TRANSITION COSTS BASED ON PITTSFIELD'S NONPERFORMANCE.

The Company failed to exercise its full contract rights to settle disputed matters involving the Pittsfield PPAs and pursue its rights under the terms of the PPAs. As a result, the Company has not demonstrated that it mitigated transition costs to the maximum extent possible.

Under the terms of the Pittsfield contract, the Company pays a significant amount in fixed charges that do not vary with the level of electricity the plant generates. The higher the kilowatt hour ("kWh") output of the plant, the lower the kWh price, and the greater the per kWh contribution to fixed cost recovery when NSTAR sells the power. Tr. 1, pp. 114-115. Pittsfield was dramatically reduced the electricity it generated beginning in September 2003. Exh. AG-1-

[3] In fact, under another set of assumptions, the benefits to customers are almost non-existent. *See* Exh. AG-3-5(b) and (i)(Confidential) (NSTAR-CAM-GOL-2 and NSTAR-GOL-COM-2) (savings to customers are less than $300,000 based on the assumption that Pittsfield was dispatched at its historic 90% capacity factor). Although the corresponding Exhibit AG-3-5 (a)(Confidential) (NSTAR-RBH-6) show savings at the 90% capacity factor of slightly more than $2 million, the Department should rely on Mr. Lubbock's exhibits to show customer savings because **REDACTED**. *See* Tr. 1, p. 201 (confidential).

10 and Exh. AG-2-2. Prior to September 2003, the Pittsfield generating unit was a fully contracted plant, with the Company holding entitlement to approximately 35 percent and USGen New England holding entitlement to 65 percent of the plant. Tr. 1, pp. 40-41, 43. In August 2003, USGen New England, which had declared bankruptcy, sought U.S. Bankruptcy Court approval to terminate its PPA with Pittsfield. Exh. AG-3. The termination of that contract resulted in 65 percent of the Pittsfield plant becoming uncommitted, coinciding with the significant decline in the Pittsfield unit's electricity output. Tr. 1, pp. 40, 42.

As a result of Pittsfield lowering the level of its kilowatt hour output, the Company's customers pay higher transition charges. Tr. 1, p.182. There is no evidence that NSTAR Electric intervened to protect its customers from financial harm in USGen New England's bankruptcy proceeding or examined the possible impact of these bankruptcy proceedings on Pittsfield's performance under the PPAs with Cambridge and Commonwealth.[4] Tr. 1, p. 182.

The Company did not inform the Department that the Pittsfield PPAs, which the Department had previously approved, had become detrimental to its customers, nor did the Company seek an advisory opinion from the Department regarding prudent actions the Company might take on behalf of its customers.[5] Tr. 1, p. 183. Indeed, the first time the Company

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[4] This type of issue likely would have been discussed at a meeting of the administration committee which was established in the PPAs (Exh. NSTAR-CAM-GOL-1, §17.6, p. 16 and NSTAR-COM-GOL-1, §17.6, p. 16), but because these meetings were conducted by telephone, no record of the administrative committee discussions exists after February 12, 1997. RR-AG-3.

[5] The Department has jurisdiction to determine issues in a contract dispute. In *Tenaska*, Tenaska filed a petition with the Department asking the Department to investigate its claim that Commonwealth wrongfully terminated an agreement between the two. *Tenaska/Commonwealth*, D.P.U. 91-200, p. 2. Tenaska further filed a demand for arbitration with the American Arbitration Association, pursuant to a clause in the agreement, which Commonwealth sought to block by filing an Application to Stay Arbitration in Middlesex Superior Court. *Tenaska/Commonwealth*, D.P.U. 91-200, pp. 2-3, *citing Commonwealth Electric Company v. Tenaska Mass, Inc.*, Civil Action No. 91-8017 (1992). The

formally contacted Pittsfield regarding its decreased output under the terms of the PPAs was four months after the event began. Exh. AG-1-1(u).

The terms of the contract specify that the Company can dispatch the plant, Exh. NSTAR-CAM-GOL-1, §4, p.5; Exh. NSTAR-COM-GOL-1, §4, p. 5, and so could have taken action to protect its customers from financial impact of Pittsfield's reduced output. The PPAs contain no provision for Pittsfield to bid into the wholesale electricity market and be dispatched by the ISO-NE according to the current market rules; only the Companies or NEPOOL can dispatch the unit. Exh. NSTAR-CAM-GOL-1, §4.1, p.5; Exh. NSTAR-COM-GOL-1, §4.1, p. 5 ("The Unit shall be subject to Economic Dispatch at the direction of the Company and NEPOOL..."). [6] The Company did not explicitly request or require, under the terms of the contract, that Pittsfield dispatch the plant at the more economic higher output levels it had experienced prior to September 2003. Tr. 1, pp. 176-177. The Company has provided only (1) a single letter from the NSTAR Electric contract administrator indicating that the Company was dissatisfied with the recent performance of the unit and (2) Pittsfield's response stating that it believes it is dispatching the unit appropriately. Exh. AG-1-1(u) and (v). The Company has provided no demand notice, no formal notice of default and no evidence to support this inaction as being

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Superior Court granted Commonwealth's request to stay arbitration, noted that the Department had primary jurisdiction over the dispute between Commonwealth and Tenaska and ordered the Department to review the dispute and identify the issues appropriate for arbitration. *Id.*

[6] Several other sections of the contracts support the Company's ability, not Pittsfield's, to determine the unit dispatch level, including (1) the definition of Economic Dispatch in Article 1; (2) Article 17, Miscellaneous Provisions, which includes both an integration clause and a provision that gives the Company the right to impose substitute standards if NEPOOL ceases to establish the NEPOOL standards referred to throughout the agreement, s*ee* Exh. NSTAR-CAM-GOL-1 and NSTAR-COM-GOL-1; and (3) Appendix B (pricing provisions) to the PPAs, where, under the Monthly Energy Charge section, energy prices may be renegotiated to achieve a price of gas that will allow the unit to be dispatched as a baseload fossil fuel electric generating plant. *Id.*, Appendix B, item 4, Page B-2.

prudent.

There is no other evidence that the Company evaluated different options in order to terminate the PPAs, even though CEA raised several issues the Company could explore further. *See* AG-1-5 Confidential and Exh. AG-2 Confidential. In *Boston Edison Company/Down East Peat, L.P.*, D.P.U. 92-183, the Department, in a hearing on the record, explored various aspects of the proposal, including the costs and savings of different options, before approving the buyout as submitted. *Tenaska Mass, Inc./Commonwealth Electric Company*, D.P.U. 91-200, p. 6 (1993), *citing Boston Edison/Down East Peat, L.P.*, D.P.U. 92-183 (1992). The Company did not explore any other alternatives to this buyout, including terminating the PPAs with Pittsfield for non-performance.[7] RR-AG-4. Clearly, the Company cannot now offer this buyout as the best way to mitigate transition costs to the maximum extent when it failed to consider all its options.

Since September 2003, Pittsfield's performance under the PPAs has caused the Company's ratepayers to pay higher costs while the Company neither informed the Department or immediately determined its remedies under the PPAs. Tr. 1, p. 182. The Company, if it had examined its remedies under the PPAs more closely, may have been able to negotiate an even better termination agreement with Pittsfield, or terminate the PPAs outright based on Pittsfield's nonperformance, rather than settle for one that yields only minor savings. Tr. 1, p. 116. The Company has not demonstrated that it mitigated the transition costs to the maximum possible extent.[8] Therefore, the Department should reject its Petition.

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[7] The record shows that CEA raised issues **REDACTED**. Exh. AG-2 (Confidential).

[8] A termination of the Pittsfield PPAs for nonperformance could save customers up to $95 million based on CEA's above-market cost assumptions. *See* Exh. NSTAR-RBH-6 Errata, p. 1(sum of lines 4 and 11).

B. THE COMPANY AND CEA DID NOT ADEQUATELY DETERMINE THE VALUE OF THE PITTSFIELD PPAS.

The Company and CEA did not adequately evaluate several factors, including the termination of USGen New England's PPA with Pittsfield and the Company's dispute with Pittsfield, when determining the value of the Pittsfield PPAs. Prior to the termination of the USGen New England/Pittsfield PPA, the Pittsfield unit was a fully contracted plant. Tr. 1, p. 43. With the termination of USGen New England's PPA with Pittsfield and the economic inefficiency of running the unit at a higher capacity without a guaranteed buyer of 65 percent of the electricity output, Pittsfield most likely will not return to the capacity factor it experienced prior to September 2003. The lower operating performance of Pittsfield under the PPAs, beginning in September of 2003 as a result of USGen New England's termination of its PPA with Pittsfield, affected the value the PPAs would have to bidders in the auction process.

The Company's dispute with Pittsfield also has an impact on the PPAs' valuation. In a letter dated January 26, 2004, the Company asked Pittsfield to return to its prior bidding and operating practices which would increase the Pittsfield unit's capacity factor to previous levels, such as 98 percent in December 2002. Exh. AG-1-1 (u). Pittsfield did not agree with the Company's characterization of Pittsfield's performance under the PPAs and this dispute continues.[9] Exh. AG-1-1 (v); Tr. 1, p. 25. The dispute could have affected the value of the PPAs for other bidders in the auction process because it presented a continuing uncertainty. The dispute may also have given an advantage to Pittsfield as one more bargaining item over other

[9] The proposed termination agreement, however, contains provisions to dissolve all disputes between the Company and Pittsfield. Exh. NSTAR-1, Appendix A and B, p. 4-5.

bidders in the auction process. CEA, however, only factored into the valuation of the PPAs the decline in the plant's capacity factor, not the dispute itself, and was not familiar enough with the terms of the dispute to offer any opinion on how the Company should resolve it. Tr. 1, p. 48-49.

Since the Company did not assign an appropriate value to the Pittsfield PPAs[10], the Petition may not be the best termination agreement available for the Company's customers. Therefore, the Department should not approve the Company's Petition.

C. ERRORS DISCOVERED IN THE PETITION'S MODELS RAISE QUESTIONS REGARDING THE ACCURACY OF THE COMPANY'S AND CEA'S CALCULATIONS.

In response to both Attorney General and Department information requests, the Company found calculation errors in the originally filed exhibits. *See* Exh. NSTAR-RBH-6 Errata Confidential; Exhs. NSTAR-CAM-GOL-3 through 7 Errata Confidential. The Company also needed to correct several responses to information requests based on the revisions to the originally filed exhibits. See Exhs. AG-2-3(a)(att) and (b)(att) Errata Confidential, Exh. AG-2-4(att) Errata Confidential; Exh. DTE-1-32 (Supp)(att) Errata Confidential. There may be other errors that the Department and the Attorney General were unable to identify during the abbreviated discovery period. All of this raises doubts as to the accuracy of the models on which the Company bases its Petition. The Department should not approve the Company's Petition

[10] In evaluating the bids and the negotiated contract termination, the Company and CEA did not consider the value of a related contract, the power exchange agreement between the Companies, Pittsfield and New England Power Company. *See* Exh. AG-1 (Confidential). The CEA witness testified that he was unaware of this contract. Tr. 1, p. 30. CEA appears not to have factored into the evaluation of the contracts the ability of Pittsfield to sell its natural gas supply rather than generate electricity with it. Tr. 1, pp. 166-167. Exhibit AG-2 (Confidential) indicates that at least one CEA staff member explored the idea **REDACTED**. Exh. AG-2 (Confidential), p. 2. The Company's customers pay the gas transportation costs whether or not the gas transported is used to generate electricity for the benefit of the Companies. Tr. 1, pp. 168-169. The customers have provided significant value, in the form of paying for the transportation of gas to the Pittsfield site, to Pittsfield, who in turn **REDACTED**.

until the calculations can be independently verified.

VI. CONCLUSION

WHEREFORE, for all of the foregoing reasons, the Attorney General requests that the Department reject the Company's Petition.

Respectfully submitted,

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